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UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Communications and Information
Washington, D.C. 20230

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APR 2 4 1997

The Honorable Reed E. Hundt
Chairman
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: Access Charge Reform, CC Docket No. 96-262, et al.

Dear Chairman Hundt:

I am writing to express the views of the National Telecommunications and Information Administration (NTIA) on the Notice of Proposed Rulemaking (Notice) in the above-captioned proceeding.[1/] The Commission proposes to reform interstate access charges for incumbent local exchange carriers (ILECs) subject to price cap regulation.[2/] The proceeding raises a welter of difficult and contentious issues that the Commission and other stakeholders have worked diligently and in good faith to resolve. A number of access reform plans are now on the record that merit careful study and fair consideration. NTIA wishes to contribute to that dialogue in the hope that we can help forge a new access charge regime that fosters local and long distance competition, promotes efficient investment in the nation's telecommunications infrastructure and, most importantly, protects customers from sharp and sudden rate increases.[3/]

INTRODUCTION AND SUMMARY

NTIA's views on access reform are guided by four fundamental principles:

- First, and foremost, reform should produce noticeable net benefits for the ultimate users of the telephone network --

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1/ Access Charge Reform, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, CC Docket No. 96-262, et al., FCC 96-488 (released Dec. 24, 1996) (Notice).

2/ Although several of the Commission's reform proposals will affect all ILECs, id. ¶ 52, the stated focus of this proceeding is the 23 companies currently subject to price cap regulation, id. ¶¶ 50-51.

3/ NTIA also recognizes the need for separations reform. To the extent that current separations rules allocate costs to the interstate jurisdiction differently than would be the case in a competitive market, that allocation will become increasingly unsustainable. Separations reform is thus an important part of a rational pricing scheme for interstate access.

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residential and business ratepayers, especially low-volume long distance users.[4/]

- Second, as the Commission and many commenters agree, the rate structure for access services or access elements must reflect the manner in which underlying costs are incurred. As the Commission recognizes, failing to align prices with relevant costs in this fashion will tend to distort demand for access services, favor some users over others, and deter efficient entry in some instances, while inviting inefficient entry in others.[5/]

- Third, the Commission's new access charge regime must promote efficient network investments by ILECs and encourage efficient facilities-based entry by new service providers. The former is important because the ILECs' networks are and will remain a critical component of the National Information Infrastructure (NII) for the foreseeable future. If those networks are not sufficiently advanced and reliable, the promise of the NII will be too slowly realized. Increased facilities-based competition is essential to creating the marketplace forces that are the most reliable guarantors of reasonable access rates.

- Fourth, access charge reform should move towards minimizing government intervention in the marketplace to avoid market distortions that can result from unnecessary or improvident regulation.

NTIA believes these goals can best be attained through an approach that incorporates aspects of the Notice and the stakeholder plans on the record. We agree, first, that interstate access rates should be restructured to ensure that underlying costs are recovered in an economically rational fashion. Second, we endorse an immediate reduction in interstate access rates through modifications in the existing price cap plan. In the Notice, the Commission has solicited comments on a number of possible changes in the current price cap plan, such as an increase in the applicable productivity factor.[6/] NTIA believes that the record amassed in this proceeding is sufficient to justify alterations in the existing price cap plan that would effect a substantial reduction in interstate access rates. If

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4/ The need to assure that access reform benefits consumers is even more pressing in view of the effects on service prices and customer bills that can be anticipated in the wake of changes in the Commission's universal service policies.

5/ Notice ¶¶ 42-44.

6/ Id. ¶¶ 231-235.

the Commission should decide that further proceedings would be needed before making any such changes, it should conduct and complete those proceedings expeditiously. Furthermore, the Commission should consider postponing the effective date of any restructuring in access charges until completion of those further proceedings.

Any rate reduction should be targeted towards reducing common line costs and phasing out the carrier common line charge (CCLC). The Commission must also ensure that any reductions in access rates are passed through to long distance ratepayers, particularly those basic schedule ratepayers that historically have not benefitted from such reductions.

NTIA also favors a market-based approach to drive access rates down in future years. Under that approach, ILECs should have some reasonable, but limited, flexibility to reduce their access rates in response to competitive developments. We therefore recommend that the Commission immediately commence a proceeding to determine the conditions for such flexibility. Continuation of any market-based approach past January 1, 1998, however, must be contingent upon the ILECs' full compliance with their obligations under the 1996 Act to interconnect with competing providers or to provide them with operational unbundled network elements on just, reasonable, and nondiscriminatory terms. If ILECs fulfill those obligations, the Commission could afford them an additional degree of pricing flexibility. If they do not, we urge that the Commission immediately prescribe further reductions in access rates in accordance with any methodology it deems appropriate.

DISCUSSION

A. Rate Structure Issues

The Commission is correct that altering the structure of interstate access charges "is a necessary first step in the new procompetitive era."[7/] As the Commission points out, the principal problem with the current rate structure is that it compels ILECs to price access services in a way that does not reflect the way in which underlying costs are incurred.[8/] In particular, certain non-traffic-sensitive (NTS) costs are currently recovered through usage-based charges, which distort demand for access services and also encourage uneconomic bypass of ILECs' local exchange networks. As a general proposition, NTIA believes that the existing access charge rate structure should be modified to effect economically rational recovery of

7/ Id. ¶ 56.

8/ Id. ¶ 55.

NTS costs. In particular, we believe that the following charges need to be examined:

1. Common Line Charges

When the Commission created interstate access charges more than a decade ago, it found that the costs of the loop facilities from the ILEC switching office to the subscriber's premises were NTS in nature. It concluded further that the interstate portion of those costs would be recovered most efficiently by means of a flat-rate subscriber line charge (SLC) paid by each subscriber.[9/] Ultimately, however, the Commission elected to recover only a portion of interstate loop costs through the SLC, with the remainder being recovered via a per-minute CCLC payable by all interstate interexchange carriers.[10/]

Because of the economic distortions created by the CCLC, NTIA recommends that it should be phased-out. The first step would be to remove from the interstate portion of the ILECs' subscriber loop costs all costs that will be recovered through the new universal service mandated by the 1996 Act. This reduction will both prevent duplicate recovery of such costs by ILECs and permit a corresponding decrease in the CCLC.

Second, and as noted above, the current price cap plan should be modified so as to implement a "down payment" within the context of the price cap record on future access rate reductions applied to eliminate all remaining common line costs currently recovered by the CCLC. If that down payment exceeds remaining CCLC costs, the excess should be used to reduce proportionately SLCs for all customers.

We have some questions about the Commission's proposal to lift the cap on the SLC for multi-line business customers, for second and additional lines to an individual's primary residence, and for all lines to non-primary residences.[11/] Before lifting any existing SLC cap, the Commission should first investigate the effect of such an SLC increase on the market for and cost of additional telephone lines. If it determines that a one-time SLC increase would sharply impede the market for additional lines, the Commission should consider phasing-in an increase in the SLC

9/ MTS and WATS Market Structure, 93 FCC 2d 241, 279, recon., 97 FCC 2d 682 (1983), second recon., 97 FCC 2d 834 (1984).

10/ Today, the CCLC generates some $3.7 billion in revenues for the largest ILECs, as compared to $7.1 billion for the SLC. Notice ¶ 29, Table 1.

11/ Id. ¶ 65.

cap over several years.[12/] Under no conditions, however, should any SLC exceed the relevant per-line loop costs assigned to the interstate jurisdiction.

Finally, the Commission should modify the way in which it applies SLCs to ISDN services. Rather than assessing a SLC on each derived ISDN channel, the Commission should consider, as some parties suggest, computing ISDN SLCs based on the relative costs of providing ISDN services compared to corresponding standard analog services.[13/] Any additional revenues generated by these changes should be used to reduce dollar-for-dollar the CCLC.

2. Local Switching

The Commission suggests that certain components of local switching, such as line cards, are not traffic-sensitive and tentatively concludes that it should recover those costs through flat-rate charges. Further, it suggests that a combination of flat-rate and usage-based charges may best reflect economic costs. Consistent with the principle of moving toward efficient recovery of costs, NTIA supports the development of a local switching rate structure that mirrors the way in which those costs are incurred.

3. Transport

NTIA generally supports the Commission's proposal to reform the rate structure for transport services. Specifically, we agree that the Commission should continue to mandate flat-rate charges (1) for entrance facilities connecting an interexchange carrier's point of presence to the ILEC's serving wire center

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12/ NTIA also strongly supports the Joint Board's opposition to any increase in the current SLC cap of $3.50 per month for the first line to an individual's primary residence. Id.

13/ Id. ¶¶ 69-70. For example, data available to the Commission suggests that the ratio of costs for basic rate ISDN and conventional analog service is approximately 1.24 to 1. Id. ¶ 70. The Commission could therefore surmise that an appropriate SLC for basic rate ISDN would be 1.24 times the applicable SLC for a comparable analog service. As a separate matter, the Commission and State regulators should conduct an expeditious and thorough investigation of the rates that ILECs charge for their ISDN services to ensure that those prices closely approximate the costs of providing ISDN.

(SWC)[14] and (2) for dedicated transmission facilities between the SWC and individual ILEC end offices.[15] With respect to tandem-switched transport services, NTIA recommends that the Commission require a flat-rate charge for circuits between the SWC and the tandem switch, which typically are dedicated to a single interexchange carrier (IXC), and a usage-based charge for the shared facilities connecting the tandem switch to the ILEC end office.[16] Finally, to the extent that some costs of the tandem switch itself do not vary with usage, they should be recovered through a flat-rate charge, as is the case with end office switching.[17] The remaining tandem switching costs should be recovered through usage sensitive rates. All of the foregoing charges would, of course, be assessed on IXCs, rather than end users.

NTIA also favors elimination of the per-minute transport interconnection charge (TIC), if not immediately, over a period not to exceed three years.[18] As the Commission recognizes, because the TIC artificially increases the price of switched access minutes, it suppresses demand for interstate services and encourages inefficient bypass of the public switched network.[19] It may also give ILECs a competitive advantage in the provision of interstate transport services.[20]

We believe that the TIC can be reduced expeditiously by first reallocating network costs currently recovered via the TIC to other access elements, and readjusting those rates accordingly. Some of those costs can easily be identified and redirected (e.g., tandem switching costs that the Commission arbitrarily shifted from the tandem switching rates to the TIC; certain SS7 signalling costs could be transferred from the TIC to

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14/ As the term implies, the SWC is the ILEC switching office that serves the interexchange carrier's (IXC) point of presence. Id. ¶ 25.

15/ Id. ¶ 86.

16/ Id. ¶¶ 87-88.

17/ Id. ¶ 89.

18/ See id. ¶ 114 (noting that Ameritech has proposed a three to five year transition).

19/ Id. ¶ 97.

20/ Id. ¶ 18. See also Comments of Teleport Communications Group Inc., Access Charge Reform, CC Docket No. 96-262, at 18-21, 29-33 (filed Jan. 29, 1997).

a signalling rate element).[21/] Additionally, ILECs have made colorable claims that certain costs now recovered via the TIC should be reassigned to other rate elements.[22/] If those ILECs can convincingly demonstrate that such costs should be recovered through specified rate elements, the Commission should permit their recovery. Finally, to the extent that the TIC recovers costs that the current separations procedures have misallocated to the interstate jurisdiction, separations changes would be appropriate during the transition period to permit complete elimination of the TIC by the end of that period.

B. Access Rate Levels

Many observers sense that existing access rates are too high, although there is no agreement about the magnitude of that excess, the reasons for it, and the proper response to it.[23/] The Commission requests comment on two alternative means of achieving reasonable interstate access charges. The first -- a "market-based" approach -- would rely on steadily strengthening "marketplace forces to move interstate access prices to more economically efficient levels" over time.[24/] The second is a "rate prescription," under which the Commission "would move access rates to forward-looking economic costs in a . . . predictable and uniform manner."[25/]

NTIA shares the Commission's goal of reasonable interstate access rates.[26/] Available TSLRIC cost studies suggest that

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21/ See Notice ¶¶ 102-103.

22/ See id. ¶¶ 103-107 (noting claims made by the United States Telephone Association); Comments of U S West, Inc., Access Charge Reform, CC Docket No. 96-262, at 59-62 (filed Jan. 29, 1997).

23/ See Notice ¶ 41.

24/ Id. ¶ 161.

25/ Id. ¶ 218.

26/ We have some reservations about rate prescription as a means of achieving that end, because of the difficulty of identifying the "correct" price point. See also Comments of the Illinois Commerce Commission, Access Charge Reform, CC Docket No. 96-262, at 23-25 (filed Jan. 29, 1997). We have concluded, however, that a total service long run incremental cost (TSLRIC) model could be used to establish the lower bound of a zone of reasonable prices should a prescriptive approach be adopted. See Reply Comments of the National Telecommunications and Information Administration, Implementation of the Local Competition Provisions of the

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there is a large gap between current access rates and the costs of providing access services.[27] Those studies reinforce experience gained from the growth of competition to date, which implies that the ILECs' monopoly local networks also contain a substantial amount of excess costs that should not be recovered through interstate access rates.[28]

For these reasons, NTIA favors an immediate "down payment" within the context of the price cap record from ILECs on future access reductions, in the form of an immediate decrease in their current interstate access rates.[29] The reduction should take

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26/ (...continued from preceding page) Telecommunications Act of 1996, CC Docket No. 96-98, at 18-24 (filed May 30, 1996).

27/ Comments of MCI Communications Corp., Access Charge Reform, CC Docket No. 96-262, at 8-9 (filed Jan. 29, 1997).

28/ NTIA understands that some ILECs may claim that some of these excess costs were prudent when incurred and that, therefore, ILECs are entitled to recover them. NTIA believes that the Commission -- in conjunction with State regulators -- should initiate a proceeding to determine how the Commission will address and resolve ILEC claims about "stranded" investments.

29/ As noted above, the goal would be expeditious elimination of the CCLC. There is credible evidence in the record that a significant portion of the ILECs' costs are not attributable to the provision of basic telephone service and interstate access. MCI has estimated, for example, that more than 55 percent of Tier 1 ILECs' total network costs represents over-built plant, excess customer operations expenses, excess corporate operations expenses and inefficiencies. See Notice ¶ 247. AT&T has offered evidence that about $30 billion of the ILECs' net book investment is in facilities and equipment that are not necessary to provide either basic telephone service or exchange access. See Kravtin, Selwyn and Laszlo, "Reply to Incumbent LEC Claims to Special Revenue Recovery Mechanisms" (Attached to Reply Comments of AT&T Corp., Access Charge Reform, CC Docket No. 96-262 (filed Feb. 14, 1997)). It is also worth noting that a proposal recently offered by AT&T and Bell Atlantic/NYNEX would immediately reduce per minute interstate access charges by $2.5 billion on July 1, 1997. "AT&T, Bell Atlantic, NYNEX To Submit Compromise Proposal To Reform Universal Service, Access Charges" (Joint Press Release dated Apr. 4, 1997). Although the parties would apparently allocate that reduction differently than NTIA (focusing first on reducing the TIC), the AT&T/Bell Atlantic/NYNEX agreement demonstrates that a "down payment" with the context of the price cap record of a size sufficient to phase out the CCLC should

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place after access rates have been restructured to recover costs more efficiently. NTIA expects, moreover, that in keeping with the public commitment by the major IXCs, all IXCs will pass any reductions in their access charges through to their customers, including their basic schedule tariff customers.

Even after the reduction has been implemented, it is important for the Commission to provide a blueprint for further reductions in access rates.[30/] The Commission should, of course, continue its vigorous efforts to foster facilities-based in local telecommunications markets. In addition, NTIA recommends that mechanisms, including implementation of the unbundled network element platform, be put in place immediately to allow marketplace forces to induce future decreases in interstate access rates.

At the same time, ILECs should be afforded some latitude to respond to competitive pressures, but only such license as the degree of market competition warrants. Thus, for example, when ILECs have satisfied their basic obligations under the 1996 Act to interconnect with and offer unbundled network elements to competitors on just, reasonable, and nondiscriminatory terms, they should be given limited downward pricing flexibility. More expansive pricing flexibility should be withheld until ILECs do their parts to ensure that those interconnection and unbundling agreements become the engines for meaningful competition in the local exchange marketplace, as Congress intended. If the Commission, after investigation, determines that the ILECs have not faithfully discharged their obligations under the 1996 Act, it should immediately abandon a marketplace solution to access reform in favor of a prescriptive approach.

In NTIA's view, a "market-based" approach should have the following essential characteristics and safeguards:

1. Pricing Flexibility

The Commission proposes to give individual ILECs a modicum of pricing flexibility when an ILEC "can demonstrate that it faces potential competition for interstate access services in

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29/ (...continued from preceding page) cause no hardship to the ILECs, so long as that reduction is apportioned among all ILECs in a reasonable and equitable manner.

30/ We appreciate the proposal by AT&T/Bell Atlantic/NYNEX to further reduce access charges in a second stage restructuring. We have some concern, however, that this proposal results in shifting costs, rather than subjecting them to marketplace forces, which may eliminate those costs altogether.

specific geographic areas."[31] NTIA believes that the Commission should afford an ILEC some latitude in reducing access rates when that ILEC confirms that it has negotiated and implemented a State-approved interconnection agreement that satisfies section 271(c)(2) of the Communications Act. The conclusion of such an agreement provides credible evidence that the local exchange market is sufficiently open so that new entrants can begin to offer competing services. An ILEC should therefore have some ability to adjust its rates downward in response to such entry. The Commission should immediately commence a proceeding to consider the scope of and conditions on that flexibility.

2. Protection for Captive Customers

Whatever the degree of latitude that ILECs may be afforded to reduce their rates in the face of competition, the Commission should not allow them to use rate reductions offered to some access customers to justify increases in the rates charged to any of their other access customer. Negotiated rate reductions should be viewed as a clear signal that the marketplace has denied an ILEC an opportunity to recover a portion of its reported access costs. The ILEC should not be allowed to resurrect that opportunity by simply shifting those costs to more captive customers. Without this essential safeguard, NTIA cannot support a marketplace approach.

3. Rates for Terminating Access

Rates for terminating access should be no greater than rates for originating access, in the absence of compelling evidence of significant differences in the underlying costs of those two service offerings. This approach would use the marketplace forces that we expect to induce rate reductions for originating access to limit the potential for excessive terminating access rates.

4. Imputation

To the extent that an ILEC offers interstate interexchange services, it must, of course, impute access charges to its retail interstate operations.[32] For now, ILECs should be required to impute their tariffed access rates to their retail operations.

31/ Notice ¶ 168.

32/ The Communications Act imposes that obligation on the Bell Operating Companies. 47 U.S.C. §272(e)(3). Competitive fairness and efficient recovery of network costs requires that such an obligation also apply to all other ILECs that offer interstate interexchange services.

This will both deter potential anticompetitive conduct and strengthen ILECs' incentives to reduce their tariffed rates over time. When effective local exchange competition appears, the Commission should consider allowing ILECs to attribute to their interstate services the same reduced rates made available to similarly-situated IXCs.

5. Performance/Compliance Review

Finally, if the Commission chooses to adopt NTIA's modified marketplace approach, it should commence a review of its revised access charge regime no later than January 1, 1998.[33/] At that time, the Commission should consider the state of competition within the local exchange marketplace and assess the extent to which marketplace forces are inducing further reductions in interstate access rates. In particular, the Commission should determine whether ILECs have fully complied with their obligations under the 1996 Act to interconnect with competing providers or to provide them with unbundled network elements on just, reasonable, and nondiscriminatory terms. As part of that determination, the Commission should consider whether ILECs are making available to their competitors unbundled network elements and/or interconnection in accordance with operating and service standards prescribed by the Commission. The Commission should assure itself that the systems necessary for seamless interoperability of unbundled network elements and interconnected networks are in place and customers can expeditiously switch among competing local exchange service providers.

If the Commission decides that ILECs have complied with these obligations, it should afford them an additional degree of pricing flexibility.[34/] If the Commission concludes that the ILECs have not, it should immediately prescribe further reductions in access rates in accordance with any methodology it deems appropriate.

33/ The Commission would, of course, continue to review and to adjust interstate access rates annually in accordance with its price cap plan. It could address other implementation issues at that time.

34/ Such additional pricing flexibility might include greater freedom to deaverage rates geographically or among customer groups, and flexibility to depart from or to alter particular access rate elements. As competition develops, the Commission could also consider relaxing somewhat the constraints discussed above with respect to imputation and the pricing of originating and terminating access.

CONCLUSION

NTIA applauds the Commission for undertaking a much needed examination of the existing access charge regime. We are encouraged by the proposals of various parties to come to grips with the economic imperatives of this challenge, while ensuring the customers are the net beneficiaries of the effort. We hope that the proposal set forth herein will advance the debate to create a more flexible, less regulatory framework that will promote competition, afford carriers a reasonable opportunity to recover costs incurred in providing service and, most importantly, ensure reasonable rates for all telecommunications service users.

Sincerely,

Larry Irving

Larry Irving

cc: Commissioner James H. Quello
Commissioner Rachelle B. Chong
Commissioner Susan Ness